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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION TWO

MICHAEL PATRICK KELLY,

Plaintiff and Appellant,

v.

VICTOR A. HOLLANDER,

Defendant and Respondent.

B240829

(Los Angeles County  
Super. Ct. No. SC112254)

APPEAL from a judgment and order of the Superior Court of Los Angeles County. Craig D. Karlan, Judge. Reversed and remanded.

Michael Patrick Kelly, in pro. per., for Plaintiff and Appellant.

Munger, Tolles & Olson, Joseph D. Lee, Leo Goldbard for Defendant and Respondent.

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Plaintiff Michael Patrick Kelly appeals from a judgment after a motion for judgment on the pleadings was entered in favor of defendant Victor A. Hollander. Because we find that the trial court should have allowed Kelly the opportunity to amend his complaint, we reverse.

### **FACTS<sup>1</sup>**

Hollander is an independent director of Fuqi International, Inc. (Fuqi) and chairman of its audit committee. Fuqi is a publicly traded company that designs and sells precious metal jewelry in China. It went public in the United States in 2007 and had a secondary stock offering in 2009, raising approximately \$150 million.

Kelly is a shareholder of Fuqi who invested substantial amounts in the company. In 2009 and 2010, he bought over \$2 million of Fuqi shares.

After numerous quarters reporting stellar growth, Fuqi issued a press release and filed an 8-K form in March 2010 stating that its prior financial statements were not reliable. Fuqi indicated that the statements would be amended and “restatements” would be issued, and that its 2009 annual report would not be timely filed. Fuqi described the problem with its prior financial statements as minor and estimated that the restatements would reflect a rather immaterial net adjustment of less than 20 cents earnings per share.

Over the next year, neither the restatements nor the 2009 annual report were issued, and Fuqi provided no explanation for the delay. The price of the stock declined precipitously from a high of approximately \$32 in September 2009 to approximately \$1.50 in November 2011.

Kelly alleges that, beginning in September 2010, he “set on a course of action to uncover the truth as to why such an apparently benign accounting issue could take so long to correct and re-state. The Plaintiff having already lost a substantial amount of

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<sup>1</sup> The facts are taken from the allegations in the second amended complaint. On review of a motion for judgment on the pleadings, we must assume the truth of all material facts that were properly pleaded. (*Gilmer v. Ellington* (2008) 159 Cal.App.4th 190, 194, fn. 1; *Moore v. Regents of University of California* (1990) 51 Cal.3d 120, 125.)

money from the fall of the stock price was concerned that the entire company could be another Chinese fraud. The Plaintiff was not interested in trading the stock, in gathering any insider information, but in simply learning the truth.”

Kelly proceeded to make contact with Hollander. In October 2010, Kelly had a telephone conversation with Hollander in which Hollander told him that that there was “no fraud at Fuqi,” that restatements would be filed within 15 days, and that the cumulative adjustment would be similar to that indicated in the March 2010 press release. According to the complaint, Hollander knew that this statement was false when he made it because he knew that over \$100 million in cash raised from Fuqi’s stock offering had been embezzled. Hollander knew that a restatement could not be filed within 15 days and that, if any adjustment were made, it would be much greater than the amount indicated in the prior press release. Kelly alleges that Hollander was deliberately attempting to mislead him and that he relied on Hollander’s false representations and continued to hold stock because of them.

A few days after the telephone call, Kelly and his son had lunch with Hollander in Beverly Hills. Hollander again told him that Fuqi would file restatements within 15 days. Kelly alleges that Hollander knew this representation was false, but that Kelly again relied on the representation and continued to hold the stock.

Kelly further alleges that during the same lunch meeting Hollander told him that Fuqi would do nearly \$1 billion in sales for 2010. The complaint states that this information “had never been released to the street and was inside information. Mr. Hollander broke the law by telling the Plaintiff this information. In fact the entire business of Fuqi International Inc. is built on deceit, non-disclosure, embezzlement, etc. Mr. Hollander intended to induce the Plaintiff to not only hold the stock he presently owned but in fact to buy more stock. The Plaintiff did not trade on this information as that would have been illegal, but continued to hold stock because of this statement.”

Following the lunch meeting, and up through December 2010, Kelly had numerous further phone conversations with Hollander, along with visits to his office and home. Hollander never said that his prior representations were untrue. In December,

Hollander told Kelly about his experience with a NASDAQ panel relating to Fuqi's delisting from the stock exchange. Hollander stated: "The meeting went as well as could be expected. Fuqi was a real company with cash." Kelly's complaint calls this statement a "damn lie." On another occasion, Hollander told Kelly that an independent investigation was conducted and that no fraud was discovered at Fuqi. Again, Kelly alleges that Hollander knew this statement to be false when he made it.

Kelly alleges that, overall, he engaged in at least 20 phone conversations and talked with Hollander several times in person. During each conversation, Hollander assured him that accounting deficiencies would be resolved and restatements would be filed soon. Kelly relied on these representations, which Hollander knew to be false.

Kelly purchased a total of 164,400 shares of Fuqi stock and sold 124,400. He alleges he suffered a net loss of \$425,000.

### **PROCEDURAL HISTORY**

Kelly, acting in propria persona, filed suit against four independent directors of Fuqi and other defendants in April 2011. After suffering defeat on a string of demurrers, Kelly filed a second amended complaint in November 2011 against only Hollander and Lily Lee Chen, another Fuqi independent director. The second amended complaint asserts a single cause of action for fraud.

Chen filed a demurrer to the second amended complaint, which was sustained. Judgment in her favor was entered on January 24, 2012. No appeal was filed from that judgment.<sup>2</sup>

Hollander initially answered the second amended complaint. However, shortly after Chen's demurrer was heard, Hollander filed a motion for judgment on the pleadings.

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<sup>2</sup> Kelly repeatedly makes reference to Chen in his opening brief, as if we may reverse the judgment in her favor. Because no notice of appeal as to Chen was filed, we are without jurisdiction to consider the judgment in favor of Chen. (Cal. Rules of Court, rule 8.100; Code Civ. Proc., § 906.)

The court granted the motion on March 28, 2012, and entered judgment the same day. Kelly's appeal from that judgment is timely.

## **DISCUSSION**

### **I. Standard of Review**

A motion for judgment on the pleadings serves the function of a demurrer, challenging defects on the face of the complaint. (*Cloud v. Northrop Grumman Corp.* (1998) 67 Cal.App.4th 995, 999.) In reviewing the sufficiency of a complaint, factual allegations are accepted as true and given a liberal construction. (*Gerawan Farming, Inc. v. Lyons* (2000) 24 Cal.4th 468, 515-516.) We do not concern ourselves with whether a plaintiff may have difficulties in proving the claims made in the complaint. (*Desai v. Farmers Ins. Exchange* (1996) 47 Cal.App.4th 1110, 1115.) Rather, we determine de novo whether the facts as alleged support a valid cause of action or, if they do not, whether amendment could cure the defect. (*Kempton v. City of Los Angeles* (2008) 165 Cal.App.4th 1344, 1347.) "Where a complaint could reasonably be amended to allege a valid cause of action, we must reverse the judgment." (*Id.* at p. 1348.)

### **II. Leave to Amend Should Have Been Allowed**

Kelly contends that he properly pled a fraud cause of action against Hollander. The elements of fraud are: (1) a material misrepresentation (including false representation, concealment, or nondisclosure); (2) knowledge of its falsity; (3) intent to induce reliance; (4) justifiable reliance; and (5) resulting damages. (*Robinson Helicopter Co., Inc. v. Dana Corp.* (2004) 34 Cal.4th 979, 990.) Each element of a fraud claim must be pled with particularity. (*Beckwith v. Dahl* (2012) 205 Cal.App.4th 1039, 1059-1060.)

Kelly alleges that Hollander's misrepresentations induced him to refrain from selling his Fuqi stock. Our Supreme Court has held that a person need not sell or buy shares to state a fraud cause of action in the context of a stockholder's action. (*Small v. Fritz Companies, Inc.* (2003) 30 Cal.4th 167, 171 (*Small v. Fritz*)). Instead, if a shareholder is induced to refrain from selling stock by a material misrepresentation and is damaged as a result, he or she may properly state a fraud cause of action. (*Ibid.*)

The trial court recognized the application of *Small v. Fritz* to the instant matter in that Kelly could properly state a fraud claim based upon the holding (rather than buying or selling) of shares. The trial court found, however, that Kelly was unable to adequately plead that he relied on Hollander's misrepresentations. When a plaintiff materially alters his or her legal relations as a result of the defendant's misrepresentation, actual reliance is said to occur. (*Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 976-977.)

The trial court found, and Hollander argues in his respondent's brief, that Kelly was foreclosed from claiming reliance because he conceded in his complaint that he never intended to rely on Hollander's statements. Hollander points to paragraph 17 of the second amended complaint, in which Kelly alleges that in September 2010 he set out to investigate Fuqi's accounting problems and that he "was not interested in trading the stock . . . but in simply learning the truth."

If this were the only allegation pertaining to reliance, we would agree that Kelly could not properly state a fraud claim. But it is not. Kelly alleges that after he began his investigation he spoke with Hollander both in person and over the phone. The complaint alleges that during these conversations, Hollander knowingly made misrepresentations. With respect to nearly all of these misrepresentations, Kelly alleges that he "relied on the representation and continued to hold stock because of this statement." We must give the allegations a liberal construction. (*Gerawan Farming, Inc. v. Lyons, supra*, 24 Cal.4th at pp. 515-516.) Simply because Kelly "was not interested in trading the stock" when he first began his investigation does not mean that he could not later change his mind. Kelly alleges that Hollander made fraudulent statements to him and that he held his stock because he relied on the statements. Reading these allegations liberally (as we must), the necessary conclusion is that, if not for Hollander's misrepresentations, Kelly would have sold his stock, despite his initial lack of interest in doing so.

The trial court's second basis for granting the motion for judgment on the pleadings—and Hollander's second primary argument—is that Kelly could not possibly show reliance because, were he to actually sell the stock, he would have been engaging in

illegal insider trading by selling shares based on material, nonpublic information. This finding also improperly construes Kelly’s allegations too strictly. In only one paragraph of his second amended complaint (paragraph 26) does Kelly allege that Hollander disclosed inside information—that Fuqi “would do nearly \$1B in sales for 2010.” None of the other paragraphs alleges that Hollander revealed material, nonpublic information. Instead, according to the complaint, Hollander kept repeating that restatements would issue soon, that they would be of minor importance, and that there was no fraud in the company. Kelly alleges he did not trade because of misrepresentations that the company was as healthy as previously portrayed. The potentially inside information was what was left *unsaid*—that (according to the complaint) the company was a sham. We need not at this stage, if ever, decide the hypothetical implications of Kelly’s trading on unrevealed information.<sup>3</sup>

We do find Kelly’s second amended complaint lacking in one respect, however. *Small v. Fritz* held: “In a holder’s action a plaintiff must allege specific reliance on the defendants’ representations: for example, that if the plaintiff had read a truthful account of the corporation’s financial status the plaintiff would have sold the stock, *how many shares the plaintiff would have sold, and when the sale would have taken place*. The plaintiff must allege actions, as distinguished from unspoken and unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the

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<sup>3</sup> In any event, a finding of insider trading generally involves questions of fact, matters not properly decided on a motion for judgment on the pleadings. Under the “misappropriation theory” of insider trading, it must be shown that a “tippee” knows that “tipped information is material and non-public,” and the tippee “must have some level of knowledge that by trading on the information the tippee is a participant in the tipper’s breach of fiduciary duty.” (*S.E.C. v. Obus* (2d Cir. 2012) 693 F.3d 276, 287.) Whether the tippee knows that the tipper breached a duty by relaying confidential information is a “fact-specific inquiry turning on the tippee’s own knowledge and sophistication, and on whether the tipper’s conduct raised red flags that confidential information was being transmitted improperly.” (*Id.* at p. 288.) Furthermore, the issue of whether information is material is generally a question for the trier of fact to decide. (*S.E.C. v. Talbot* (9th Cir. 2008) 530 F.3d 1085, 1097.)

misrepresentations.” (30 Cal. 4th at p. 184, italics added.) Kelly did not allege how many shares he would have sold and when he would have sold the shares if not for Hollander’s misrepresentations. Because it appears that Kelly could reasonably amend his complaint to specifically allege this information, he should be given the opportunity to do so. Leave to amend, therefore, should have been granted.<sup>4</sup>

### **III. Claims of Judicial Misconduct Are Baseless**

Rather than concentrate on the merits of his appeal, Kelly devotes much of his opening brief to attacking the trial court judge—saying that he dismissed Kelly “like an ugly stepchild” and claiming that he “blow[s] hot air.”<sup>5</sup> Kelly points to no part of the record that actually gives any indication that the trial judge failed to act with impartiality. Indeed, the reporter’s transcript shows that the judge was courteous and engaging, and gave Kelly a generous opportunity to argue his points. The trial court’s apparent confusion over whether Kelly filed an opposition to the motion for judgment on the pleadings stemmed not from a lack of diligence or impartiality, but rather from Kelly’s choice to name his opposition a “motion to stay proceedings until limited discovery is complete, opposition to motion for summary judgment.” Kelly fails to provide any basis for his assertion that the trial court judge was biased against him.

While we are mindful that Kelly is representing himself, and may not be aware of many procedural norms and rules, his status as a plaintiff appearing in propria persona does not provide him with an excuse to act inappropriately. A party appearing in propria persona “is to be treated like any other party and is entitled to the same, but no greater consideration than other litigants and attorneys.” (*Barton v. New United Motor*

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<sup>4</sup> Of course, if Kelly does not adequately allege such information in his third amended complaint, Hollander may bring another demurrer or motion for judgment on the pleadings.

<sup>5</sup> Kelly’s “Opposition to Respondent Brief” contains even more inappropriate comments directed against the trial court judge (e.g., “[h]e does not know his ass from his elbow when it comes to insider trading”).

*Manufacturing, Inc.* (1996) 43 Cal.App.4th 1200, 1210.) Attorneys have the obligation to demonstrate “civility, professional integrity, personal dignity, candor, diligence, respect, courtesy, and cooperation, all of which are essential to the fair administration of justice and conflict resolution.” (See California Attorney Guidelines of Civility and Professionalism (July 2007), Introduction.) Simply because Kelly is not an attorney does not give him justification to treat those in the judicial system (or anyone else) with a lack of courtesy and respect. If Kelly chooses to continue to represent himself following remand, he is expected to act in a manner befitting of this right and responsibility.

**DISPOSITION**

The judgment and order granting without leave to amend Victor Hollander’s motion for judgment on the pleadings as to Michael Patrick Kelly’s second amended complaint are reversed. The matter is remanded to the trial court with directions to enter a new order granting the motion for judgment on the pleadings with leave to amend and allowing Kelly to file his third amended complaint within 30 days. The parties are to bear their own costs on appeal.

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BOREN, P.J.

We concur:

ASHMANN-GERST, J.

CHAVEZ, J.